UNITED STATES SENATE
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Larry E. Craig, Chairman
Jade West, Staff Director

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Why Energy Price Controls Won't Work

"Price controls have a record of causing shortages going back at least as far as the days of the Roman Empire. Price controls on food have produced shortages, malnutrition and even starvation. Rent control has produced housing shortages from New York to Paris to Hong Kong. But no politician wants to admit that price controls have produced an electricity shortage in California."

– Stanford Economist Thomas Sowell [3/22/01]

For years, some Democrats advocated artificially raising energy prices as a means of increasing our energy independence and reducing pollution. Towards that end, they voted to raise energy taxes, advocated breaching hydroelectric dams in the Pacific Northwest, and opposed exploration and development of new energy sources. Now that the consequences of their high-energy-price policies have become politically damaging, however, they suddenly want *lower* energy prices through price controls:

> "What we ought to do is pass the Feinstein bill which says to FERC: 'Look, do what you're supposed to do. Come in and regulate this in a way that allows adequate supply and some price relief.' "
>
> — Senator Tom Daschle [*Reuters*, 6/10/01]

> "You know, the President ought to call in his former colleagues from the oil industry, sit them down at the table, and say, 'Look, this is wrong. Draw a line somewhere. We don't want to have to legislate here, but if you don't charge more reasonable prices, we're going to have to put some kind of price control on.' "
>
> — Senator Joseph Lieberman [CNN's *Late Edition*, 5/13/01]

> "We would be thrilled to death if we could get the President to ask FERC to put price caps on wholesale prices on electricity on the West Coast and across this country."
>
> — Congressman Dick Gephardt [press conference, 5/17/01]

Yet, as we have learned time and again, price controls on energy are exactly the wrong solution to California's energy problems.

Price Controls: A History of Failure

Efforts to control prices are as old as government. We've literally had 4,000 years of experience with price controls – and 4,000 years of failure.

2000 BC:	The Code of Hammurabi imposes price controls on most goods and services. ("If an ass has been hired for threshing, ten qa of corn is its hire . . .") Trade plummets. Bureaucratic paperwork (on clay tablets) multiplies.
550 BC:	The Chou Dynasty forbids price to rise above their "natural" (government-set) price. Trade slows. Regulation becomes increasingly minute.
400 BC:	Athenians prescribe death for those charging more than a "just price" for grain. Many grain-sellers die. Grain remains scarce.
58 BC:	Roman wheat prices, already fixed below the market price, are reduced to zero. To the Roman Senate's surprise, most farmers drop their plows and move to the city.
AD 301:	The emperor Diocletian prescribes death for violators of price ceilings. Hoarding, riots, and death ensue. Four years later, Diocletian abdicates.
AD 806:	Charlemagne fixes crop prices to thwart "speculators." Black markets appear.
AD 1202:	Henry III of England fixes bread prices. The law is widely disobeyed.
AD 1585:	Antwerp, besieged by the Spanish Army, reacts to rising food prices by fixing them. Food supplies dwindle, then vanish. The city falls.
AD 1770:	British rulers of Bengal respond to the complete failure of the rice crop by fixing prices to "check speculation." Millions die of hunger.
AD 1777:	Pennsylvania's war-time price controls cause farmers to hoard food. Washington's army at Valley Forge nearly starves to death.
AD 1971:	Congressional Democrats try to embarrass President Nixon by granting presidential price-control authority, which, to their dismay, he actually uses. The results include an energy crisis, a recession, and double-digit inflation.
AD 1978:	President Carter proclaims "voluntary wage-price guidelines" to fight inflation, which soon after surges to double digits. He becomes a one-term president.

AD 2001: The Federal Government pursues price controls on electricity . . .

[This list was prepared by the Office of Rep. Dick Armey using a 1978 Heritage Foundation paper entitled, "Forty Centuries of Wage and Price Controls: How Not to Fight Inflation."]

Clearly, price controls have a long history of failure. Or, as Ronald Reagan once observed, wage/price controls never worked, either during the energy crisis of the 1970s or when they were tried in Diocletian's day, adding, "I'm one of the few persons old enough to remember that."

Valley Forge and Price Controls

Perhaps the most compelling example of the evils of price controls comes from General George Washington's experience wintering in Valley Forge. As Congressman Armey described it, the "states' war-time price controls had produced widespread shortages and misery, and decimated Washington's army at Valley Forge" [3/31/93 letter from Rep. Dick Armey to Colleagues]. This near disaster resulted in the Continental Congress adopting the following rejection of price controls on June 4, 1778:

> "Whereas . . . it hath been found by Experience that Limitations upon the Prices of Commodities are not only ineffectual for the Purposes proposed, but likewise productive of very Evil Consequences to the great Detriment of the Public Service and Grievous Oppression of Individuals... [Therefore, be it] resolved that it be recommended to the several States to repeal or suspend all Laws or Resolutions within the said States respectively limiting, regulating, or restraining the Price of any Article, Manufacture, or Commodity." [*Journal of the Continental Congress*]

Congressman Armey observed, "Once the controls were lifted, provisions became abundant, and by the fall of 1778, our armies were able to procure needed winter supplies that only a year before had been unavailable. I sometimes wonder how Washington's armies, and our fledgling Nation, would have fared had the ruinous price controls never been lifted."

Our Own Experience With Price Controls

We don't have to go back 4,000 years, or even 200 years, to see why price controls are bad policy. Most people can remember the 1970s, when the federal government enacted price controls on gasoline in an attempt to protect consumers from rising energy prices. The result? Gasoline shortages, long lines at gas stations, and a failed effort to micro-manage the economy. The California-based Independent Institute recalls it this way:

> "In 1973 and 1979, the federal government, blaming everyone from 'greedy' domestic oil companies to gasoline station operators to 'fuel-hogging' motorists, imposed price controls on gasoline after oil-producing countries greatly reduced the quantities of oil shipped abroad. Had price controls not been instituted by the government, a market clearing would have occurred wherein the price of gasoline would have gone up as the

> quantity of gasoline demanded met the quantity supplied. But since gasoline prices were fixed below the market-clearing level, rationing with long lines resulted. ["Rationing Our Health Care: Price Controls are Hazardous to Our Health," Simon Rottenberg and David Theroux, The Independent Institute]

These price controls, in turn, possibly cost President Carter his job. According to *Newsweek* magazine, "Energy Secretary James R. Schlesinger, in particular, had argued that lifting federal price caps and abolishing the government's byzantine allocation system would go a long way toward spurring conservation, allocating scarce fuel more efficiently, and eliminating lines at the gas pump" [*Newsweek*, July 23, 1979].

Carter refused to lift the price controls, and two years later Reagan was elected president. One of the first acts of his presidency was the lifting of price controls on crude oil.

Price Controls and Supply: An Inverse Relationship

One reason to avoid price controls is their impact on supply. The energy crisis facing California is a supply problem. Fixing energy prices lower than the market price makes the crisis worse, not better, because it discourages new supplies of energy from entering the market:

> "Price caps, in my opinion, do not produce any more energy. Not one drop, or not one kilowatt, or not any more natural gas."
>
> — Senator John Breaux

> "Price caps have a lot of problems with them. They don't tend to be effective, and they deter some companies from participating in the market."
>
> — FERC Commissioner James Hoecker (Clinton Appointee)

> "Today, electricity price controls have the same effect. Conservation is discouraged and low-cost production is shut down."
>
> — Robert Litan (Director of Economic Studies at Brookings) and Philip Verleger, *Houston Chronicle,* May 30, 2001.

Yet some Senate Democrats are calling for lower, not higher, prices through price controls. These controls create a two-fold disincentive for new suppliers to enter the market. First, the lower prices themselves send a negative signal to suppliers. Why enter a market with regulated low prices?

Second, the willingness of government to regulate prices adds another layer of uncertainty to the myriad of uncertainties already confronting energy suppliers – Will Congress lower or prolong existing price controls?

Price Controls and Conservation: You Can't Get There From Here

Another reason to avoid price controls is their impact on demand – artificially lowering the cost of energy encourages California consumers to use more energy than they otherwise would. That's bad for the environment, bad for our long-term ability to balance energy supplies with energy demand, and bad for consumers in neighboring states, who wind up paying for California's low energy costs:

> "Price caps, which Congressional Democrats endorsed yesterday as part of a broader energy strategy, will not by themselves rectify the imbalance between supply and demand that lies at the root of the California crisis. Only conservation and more generating capacity can do that."
>
> — *New York Times*, May 16, 2001

> "Artificial price controls actually mask the true cost of energy, encouraging more consumption, not less. That's the danger in the opposition plan proposed by congressional Democrats."
>
> — *Detroit News*, May 18, 2001

> "Yet price controls are counterproductive on two fronts: They leave demand raging at whatever level it's been because there is no incentive to conserve. And they cripple supply because there is no incentive for greater production, either. When controls are finally lifted, prices are likely to go right back to where they had been. If they are not lifted, the shortage might never go away."
>
> — *Rocky Mountain News*, May 19, 2001

> "There is no way out. Either retail prices must go up, or blackouts will continue with the consequent high costs to the California economy. Facing the pain now should reduce the ultimate price increase."
>
> — The Manifesto on the California Electricity Crisis, signed by numerous leading economists, including Nobel Prize Winner Robert Solow.

Price Controls Are Bad Policy

Energy price controls are incompatible with conservation and increased supplies. The Senate should encourage conservation and the development of new energy supplies, not discourage them through failed price control policies.

Opposition to price controls is not a partisan issue. Elected and non-elected officials from both sides of the aisle have expressed opposition to legislated price controls, including former Gore advisor and economist Alan Blinder:

> "Price controls throw a monkey wrench into the market mechanism. Though the market is surely not flawless, and government interferences often have praiseworthy goals, good intentions are not enough. Any government that sets out to repair what it sees as a defect in the market mechanism runs the risk of causing even more serious damage elsewhere."

Any energy policy adopted by Congress must encourage the development of new energy supplies *and* encourage Americans to conserve. Price controls result in just the opposite — more energy consumption and less energy production. It's time for *all* the Senate, Republicans and Democrats, to recognize that the California energy crisis cannot be solved through a price capping solution that hasn't worked anywhere in the world in over 40 centuries.

RPC Staff Contact: Brian Reardon, 224-2946